

***United States Court of Appeals
for the Second Circuit***



**PETITION FOR
REHEARING
EN BANC**

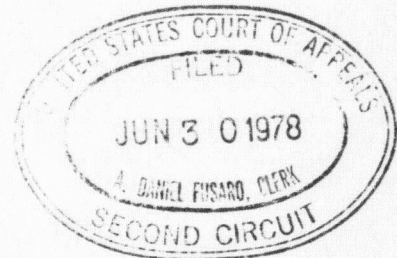
77-6034,

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77-6034, 77-6038, 77-6045, 77-6048, 77-6065

IN THE
UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

In the Matter of WEIS SECURITIES,) Appeal from the United
INC.,) States District Court
GEORGE ALDRICH, et al.,) for the
Petitioners-Appellants,) Southern District
) of New York
vs.)
EDWARD S. REDINGTON, Trustee,)
and SECURITIES INVESTOR PROTECTION)
CORPORATION,)
Respondents-Appellees.)



PETITION FOR REHEARING AND
SUGGESTION FOR REHEARING IN BANC
OF
EVA GROSSMANN

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PETITION FOR REHEARING AND
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Petitioner, Eva Grossmann, one of the appellants in this appeal, hereby petitions this Honorable Court pursuant to Rule 40 of the Federal Rules of Appellate Procedure to rehear this appeal and reconsider its judgement entered on June 12, 1978, and suggests pursuant to Rule 35 of the Federal Rules of Appellate Procedure that it would be appropriate to have a rehearing in banc because of the issues raised in this appeal.

PREFATORY STATEMENT

In the interest of brevity and to avoid repetition, Eva Grossmann has joined in the joint petition for rehearing filed on behalf of various appellants, and the points and arguments contained therein which apply to all appellants joining in that petition are not repeated here. This petition is limited to those points overlooked or misapprehended in this Court's Opinion which relate solely to the claim of Mrs. Grossmann--a claim which is separate and distinct from the claims of other appellants.

POINTS OVERLOOKED OR MISAPPREHENDED IN THIS COURT'S OPINION

1. This Court's Opinion overlooks the fact that the sale of subordinate debentures to Mrs. Grossmann was in violation of the "Know Your Customer Rule" (Rule 405) of the New York Stock Exchange and was therefore an illegal transaction.
2. Because this Court's Opinion misapprehends the nature of the transaction involving Mrs. Grossman, it overlooks the fact that the illegal actions of a stock broker and the New York Stock Exchange (which had a duty to protect her by prohibiting such a sale) cannot deprive her of the protection

of SIPA by converting her status of customer to the status of subordinate lender.

3. Because this Court's Opinion misapprehends the nature of the transaction involving Mrs. Grossmann and the fact that it is the "System" rather than customers of the broker which will profit from the denial of her claim, it overlooks the fact that the "System", which breached its duty to protect her when it approved the illegal sale of subordinate debentures to her, will profit at her expense even though she is the only party to that transaction who is innocent of any wrongdoing.

ARGUMENT

This Court's Opinion misapprehends the nature of the transaction between Mrs. Grossmann and Weis, Voisin, Cannon, Inc., the predecessor of Weis Securities, and ignores the reasons why this transaction is, as a matter of law, different from the transactions which are the basis of the other appellants' claims. The transactions of the other appellants were transactions which, if they had not been fraudulently induced, would have been otherwise legal. In contrast, the sale of

subordinate debentures to Mrs. Grossmann was in blatant violation of Rule 405 of the New York Stock Exchange ("Know Your Customer Rule")* and, therefore, regardless of fraudulent inducement, illegal.

As is set forth in the briefs previously filed in this case, Congress has created a "System" designed to protect private investors in general, and unsophisticated investors in particular. Included in this "System" are the New York Stock Exchange (NYSE), the Securities and Exchange Commission (SEC) and the Securities Investment Protection Corporation (SIPC). This "System" operates on two levels. On the first level the SEC and the NYSE are charged with the duty of protecting investors by regulating the operations of brokers. When, as in the instant case, the broker is a member of the NYSE, the NYSE is that part of the "System" which is responsible for enforcing the rules and regulations (See NYSE's Amicus

* SEC Rule 15b 10-3 is a comparable Rule that applies to broker-dealers who are not members of an exchange.

Brief pp. 9-11).

The "System" must enforce all of its rules; it not only has a duty to enforce the Net Capital Rule, but equally has a duty to enforce the "Know Your Customer Rule" which is an integral part of the "System's" regulatory scheme. Starkman v. Seroussi, 337 F. Supp. 518, 524 (S.D.N.Y. 1974). The "Know Your Customer Rule" is supposed to prevent brokers from inducing unsophisticated small investors to invest a large portion of their total assets in investments which are speculative and/or not adequately secured. This Court's Opinion overlooks the "Know Your Customer Rule" and the fact that the "System" not only failed to enforce it, but, by approving the sale of subordinate debentures to Mrs. Grossmann, actually participated in its violation.

At the time Mrs. Grossmann brought virtually her entire life savings to Weis, Vosin, Cannon, Inc. to invest, she was plainly the type of person which Congress intended should have the protection of customer status under the Securities Investor Protection Act (SIPA). Cf. SEC v. F.O. Baroff Co. Inc., 497

F. 2d 280 (2nd Cir. 1974). This Court's Opinion holds that when she was sold subordinate debentures, that transaction stripped her of the protection of customer status. However, it overlooks the fact that this transaction was illegal because it violated the "Know Your Customer Rule". The fact that the broker committed an illegal act, and the "System", which had a duty to prevent that act, approved rather than prevented it, cannot divest an innocent unsophisticated investor of the protection which Congress intended to, and did, confer upon her. To allow such a result will render the protection of SIPA illusory and violate the clear intent of Congress. However, with all due respect, that is exactly what this Court's Opinion allows when it ignores the "Know Your Customer Rule" and misapprehends the nature of the transaction involving Mrs. Grossmann.

As mentioned above, the "System" operates on two levels. On the second level the SIPA establishes a type of insurance fund held by the SIPC. If that part of the System which is charged with the duty of enforcing the rules and regulations (in this case the NYSE) fails to protect an investor by enforcing

them properly, and this failure results in a loss to the investor, the "System's" second level of protection comes into operation. On the second level the SIPC is supposed to, out of its fund, reimburse investors' losses up to the statutory limit.

As is pointed out in the Joint Petition For Rehearing, the primary beneficiary of this Court's holding that the illegal sale of subordinate debentures to Mrs. Grossmann converted her status from "customer" to that of subordinated lender is the SIPC which is an integral part of the "System" that has breached its duty to protect her. The effect of this Court's Opinion is that the "System", which failed to protect her, and by approving of the sale of subordinate debentures to her participated in an illegal transaction, profits at her expense. It is respectfully submitted that such a result is contrary to the intent of Congress which established the SIPC so that the brokerage industry itself, through the "System", rather than innocent unsophisticated small investors is to bear the loss resulting from broker-dealer insolvencies.

C O N C L U S I O N

For the reasons stated above, in the Joint Petition For Rehearing, and in the briefs of appellants, it is respectfully submitted that this Court's denial of Eva Grossmann's claim was unnecessary, inappropriate and destroys rather than preserves public confidence in the U.S. security markets.

WHEREFORE, Petitioner, Eva Grossmann urges that this Court grant rehearing and suggests that a rehearing in banc would be appropriate.

Respectfully submitted,

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MARIE L. SULLIVAN, being first duly sworn, states that she served 3 copies of the foregoing brief upon each of the parties listed below, at the addresses given this 26th day of June, 1978, by first-class mail, postage paid, Chicago, Illinois.

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of June, 1978.

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